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# The Report of the Advisory Committee on Global Product Mandating

Prepared for the Ontario Ministry of Industry and Tourism  
December, 1980.

The Advisory Committee on Global Product Mandating was appointed by the Honourable Larry Grossman, Minister of Industry and Tourism of the Province of Ontario, in April, 1980.

The membership of the committee consisted of the following senior executives of Canadian multinational affiliates:

Lorne K. Lodge (Chairman)	Chairman & President	IBM Canada Ltd.
Peter M. Brophy	Vice President, Corporate Affairs	Xerox Canada Inc.
Richard H. Campbell	President	Black & Decker Canada Inc.
Alton S. Cartwright	Chairman and Chief Executive Officer	Canadian General Electric Company Limited
Arthur E. Goodall	Vice President and General Manager, United- Carr Division	TRW Canada Limited
George J. Hubbs	Chairman of the Board & President	Control Data Canada, Limited
Everett A. Reece	Vice President and General Manager	McDonnell Douglas Canada Ltd.
Frank Tyaack	President and Chief Executive Officer	Westinghouse Canada Limited

Although we have sought the advice of a number of individuals in business, government, the universities, and various business associations in the preparation of this report, we have commissioned no studies and retained no consultants. The observations and recommendations set forth here are based on our own experience as managers of major multinational affiliates in Canada. We are, of course, grateful for the help and advice we received.

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## I. The international competitive challenge

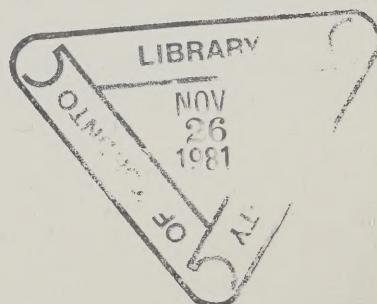
Canadian manufacturers today face a new competitive challenge. Changes in the international economy, resulting in part from recent tariff reductions and the growing industrial strength of the newly industrialized countries, will mean that manufacturers in Canada must be increasingly competitive on a global basis if they are to remain viable.

For many multinational affiliates in Canada, this will mean a continuing shift away from the traditional branch plant form of operation which evolved primarily in response to high Canadian tariffs. Typically, such plants manufactured a wide range of products, solely or primarily for the Canadian domestic market. The small size of the Canadian market and the high tariffs abroad have generally prevented these organizations from achieving the economies of scale required to compete internationally. Historically, only high Canadian tariffs and lower wage rates enabled such organizations to remain viable in the Canadian market.

Because of the reduction in Canadian tariffs agreed to in the latest round of GATT negotiations, many Canadian affiliates must develop or accelerate new strategies and new organizational structures for their operations in Canada.

All Canadian-based manufacturers, from the large foreign-owned multinationals to smaller Canadian-owned companies will similarly be required to adjust to these new competitive realities. But the multinational enterprises have some particular skills and strengths to bring to this task of adjustment. They have access to and the ability to transfer technology. They have access to or potential access to international markets. Finally, they have the potential for rationalization or manufacturing specialization based on world markets.

This report draws on our experience with the various strategies employed by firms like our own. We consider several responses to the new competitive challenges for multinational affiliates. We also recommend some general initiatives for government which we believe can help promote successful adjustment and maximize the net benefit to Canada of multinational operations in this country.



## II. Evolving multinational strategies

The most promising strategies for many multinational affiliates operating in Canada involve the implementation of specialized missions within the worldwide enterprise.

Global product mandating is one such strategy. Where a *pure* global product mandating strategy is employed, the affiliate is assigned *total* responsibility for particular products or operations within the multinational. This concept implies responsibility for all aspects of research and development, including conceptual or basic research; responsibility for manufacturing; and direct responsibility for international marketing. However, for a number of reasons, variations from this *pure* global product mandating strategy will be the usual practice.

For example, although some research and development for particular products may be done by the affiliate, an enormous pool of technology is usually available from the parent. This technology is often essential to the success of any product strategy. Access to this technology therefore represents a tremendous advantage to the affiliate and to the host country in which it operates.

At the same time, many multinational enterprises are organized with markets and/or products already assigned to other affiliates. In other words, the established marketing patterns of the firm have already reserved defined geographic territories and/or specific products for sister affiliates located in other countries.

Accordingly, the wide variations in the organizational structure and the operational philosophies of multinational enterprises, combined with

variations in the present status and capabilities of their Canadian affiliates, certainly rule out any "blueprint" approach to mission specialization.

Generally speaking, however, foreign-owned multinational enterprises in Canada are most successful when they adopt some form of specialized mission strategy. Within such a strategy, the affiliate can specialize in the production of a limited number of products for the international market. This permits the affiliate to achieve the expertise and economies of scale needed to compete not only in its own markets but internationally as well. All of the companies represented on the Advisory Committee employ such strategies in their Canadian operations.

There are many variations of the specialized mission strategy.

Where the Canadian domestic market is of world scale, firms can become internationally competitive on the basis of domestic sales. With these sales as a base, Canadian affiliates can become centres of supply for the entire multinational enterprise.

Where the Canadian market is small by international standards, as it is in most cases, world-scale manufacturing is only possible on the basis of world-wide sales. Some multinational affiliates are able to sell directly into foreign markets; others will act as sources of supply to the overseas marketing units of their multinational families.

Specialized missions will also involve varying kinds and levels of research and development. Depending on the nature of the industry and the total product mix of the particular multinational affiliate some missions will involve conceptual research. Most specialized missions will involve significant engineering development, product improvement and adaptation, and process improvement and adaptation. These activities represent by far the largest share of total research and development expenditures and employment. As a general rule, specialized missions involve significantly more research and development of all kinds than exist in traditional branch plants.

The benefits which accrue to the multinational affiliates from specialized missions are significant in other areas as well. They enable an affiliate to reduce its unit costs and thereby improve its international competitiveness. By acquiring responsibility for a mission, an affiliate is able to develop the expertise which enables it to adapt its products for particular market conditions and to produce follow-on products. The resulting improvement in management skill and sophistication, along with higher levels of employee commitment provide additional benefits. Finally, specialized missions result in increased productivity and increased overall strength for the affiliate.

However, the evolution to a specialized mission involves certain risks. For example, the affiliate becomes dependent on a relatively narrow range of specific products. If these products fail or if there is a decline in demand before follow-on products are developed, the affiliate can find itself in difficulty.

Short-term disruptions may result from the move to specialized missions. For example, as the

affiliate becomes more efficient, it will employ fewer people per unit of production. The particular mission may involve different job skills or lead to a physical relocation of certain activities which can result in transitional problems for some employees.

However, we are convinced that specialized missions bring long-term benefits to the affiliate and to the economy which greatly outweigh the risks and short-term disruptions involved. Affiliates are able to increase their exports and displace some of their imports, thereby improving Canada's balance of trade. Because affiliates are involved in more sophisticated activities, there will be increased opportunities for higher quality jobs for Canadians and an enhancement of opportunities for Canadian suppliers. All in all, specialized missions should result in a stronger, healthier manufacturing sector and, over the longer term, lead to increased employment and greater opportunities for Canadians.

Accordingly, while a specialized mission involves some risk, we feel strongly that the concept offers the best hope for improving the world competitiveness of multinational affiliates operating in Canada and for the future growth of Canada's manufacturing base. We should add, however, that no *one* formula or *single* concept can be made to apply successfully to all organizations. Rather, in our experience, a variety of specialized mission strategies is needed to best meet the unique requirements and characteristics of different organizations.

### III. Earning and maintaining a specialized manufacturing mission

It is important to understand the decision-making process which leads to the acquisition of specialized missions by affiliates within multi-national enterprises.

Such missions are not *awarded*; they must be *earned*. The affiliate has the prime responsibility to identify, justify and successfully implement a mission. In this regard, it is important that the term *global product mandating* not be misunderstood.

Canadian affiliates compete for specialized missions with affiliates in other advanced economies. Because affiliates located in such countries enjoy access to markets many times larger than the Canadian market, Canadian affiliates often compete at a disadvantage.

Competition among multinational affiliates is affected by several factors, the most important of which are economic. But equally critical in any competition for specialized missions is management capability. The skills required to carry out a specialized mission, particularly in high technology industries, may be vastly different from those required to run a traditional branch plant. This often makes it difficult for affiliates to move quickly from branch plant operations to specialized missions.

Also, competition for specialized missions among multinational affiliates does not end once a mission has been earned. The mission must also be maintained. If another affiliate in another country is able to offer significant advantages in terms of competitiveness it is possible for an affiliate to lose a mission.

It is in the interests of the managers of Canadian affiliates to earn and maintain attractive missions, as this is often the best means of increasing the size and productivity of their operations. The affiliates represented on the Advisory Committee have all been successful in earning and maintaining such missions in the past.

#### IV. The multinational and Canadian independent business

The evolution of specialized missions among multinational affiliates in Canada presents opportunities for significantly increased sales by small and medium-sized Canadian independent businesses to such affiliates. However, in order to take advantage of these opportunities, these firms will themselves need to be internationally competitive since they too will no longer be protected by high tariffs.

Several factors often prevent smaller firms from taking advantage of these opportunities. These include inadequate financing, skilled labour shortages, and lack of information on market opportunities.

However, governments can institute measures to help smaller firms increase sales to multinational affiliates. For example, governments can institute measures which make risk capital and skilled manpower more easily accessible.

For their part, multinational affiliates should search out and develop capable Canadian suppliers. For example, they should make their sourcing requirements known to smaller suppliers and encourage them to bid on these requirements. Where appropriate, governments should offset extraordinary or development costs incurred by affiliates in identifying and training suppliers or in providing them with special tools.

More extensive use of Canadian suppliers by multinational affiliates can contribute to Canada's objectives in a number of ways. Increased Canadian sourcing will reduce imports. At the same time, increased Canadian content in the products manufactured for export markets will further improve Canada's balance of trade.

The availability of dependable, world-competitive suppliers will in itself significantly contribute to the ability of multinational affiliates to win and maintain specialized missions in Canada. In our own experience, our missions have resulted in greater use of Canadian suppliers, many of whom have demonstrated an outstanding ability to improve their own efficiency and competitiveness, some to the point of developing their own export markets.

## V. Recommended initiatives for government

Governments can influence more multinationals to evolve to specialized missions in their Canadian operations. They can also contribute to the ability of affiliates to compete for attractive specialized missions. The most effective way to achieve these objectives is to emphasize *performance* rather than *ownership* of the multinational affiliate.

Most multinational affiliates are responsive to the stated objectives and policies of the governments of the host countries in which they operate. Explicit and consistent government commitments to encourage and facilitate the development of specialized missions can be extremely positive in helping the affiliate's business case. Non-existent, inconsistent or apparently hostile policies can be a disadvantage to the managers of affiliates as they compete for specialized missions. For example, government policies or statements calling for greater Canadian ownership and possible nationalization without regard to performance are understandably a serious deterrent to further investment in Canada. Rather than moving to specialized missions, which almost always involve greater dependence on the Canadian affiliate for successful world-wide operations, the temptation would be to supply the Canadian market from other countries.

The committee members are skeptical of government's ability to "pick winners" within the economy. Because so many of the ingredients for successful adjustment to the new competitive challenge are firm-specific rather than sector-specific, we question the usefulness of government efforts to designate certain sectors for support. Instead, we

believe government should support and encourage all firms which are developing world-competitive operations, regardless of their industry sectors.

This will not be achieved overnight or by government implementation of a list of programs. It will require ongoing consultation among governments, multinational affiliates, and other enterprises in the Canadian economy.

Thus, we are not setting forth in this report a list of specific recommendations for government. Instead, we identify the major areas which are of greatest concern and suggest some broad initiatives which could encourage more multinational affiliates to implement specialized missions in Canada.

Because these missions must be evolved and because they must be earned and maintained in competition with affiliates in other countries, we suggest that the most useful role government can play is . . .

. . . to advise multinational affiliates not yet employing specialized missions of the desirability of such a strategy, to the firm, and to the country;

. . . and to enhance the ability of Canadian affiliates to compete successfully for specialized missions.

If this role is to be carried out effectively, consistent government effort, in cooperation with industry, will be required in a number of key areas.

### 1. Competitiveness

Governments must concern themselves with the overall Canadian business climate and with measures to provide incentives to manufacturers attempting to establish world-competitive operations in Canada. These measures should apply to all firms, and should not discriminate against foreign-owned multinational affiliates.

The committee has identified several competitive factors which can impact affiliates attempting to establish specialized missions in Canada.

#### *A) The General Business and Investment Climate*

Undertaking a specialized mission almost always requires substantial new investment. It also accords the affiliate greater significance within the multinational enterprise because the affiliate may become the sole source for particular products or components. The way in which the multinational enterprise perceives the Canadian business climate, and the comparisons it makes between Canada and other countries, particularly the U.S., Japan, and the European Community, will have an effect on the ability of Canadian affiliates to compete for specialized missions. The following aspects are of particular concern:

#### *a) Stability*

Recent policies and statements by some governments in Canada have left in doubt Canada's commitment

to the free enterprise system. A stable and consistent legislative and regulatory environment is required, together with strong government support of the market system and a commitment to fiscal responsibility.

#### *b) The tax and incentive environment*

There is growing concern that some countries may be providing a more attractive environment for business. An internationally competitive tax and incentive environment is essential if Canadian affiliates are to compete on a world-wide basis. Canada's governments must carefully monitor and respond to significant changes in other countries.

#### *c) The regulatory environment*

The First Ministers' conference in 1978 identified a number of concerns in this area. The resulting focus given to regulatory reform is most welcome and should be encouraged. All regulatory policies should be assessed in terms of their impact on the international competitiveness of Canadian industry.

#### *d) Statistics*

To better prepare their business cases for specialized missions, Canadian affiliates need statistical information which compares such factors as domestic taxes, incentives, etc., with those of other countries. Governments should publish such information on a regular basis.

## *B) Specific Measures to Promote International Competitiveness*

Members of the committee have found a number of government incentive programs useful in their efforts to earn specialized missions. The following measures are of particular relevance:

### *a) Performance incentives and grants*

Government incentive programs such as investment tax credits and industrial development grants have proven useful in earning and maintaining specialized missions. Such programs should continue to be available to all firms regardless of their ownership, where their performance contributes to the achievement of Canadian industrial objectives.

### *b) Research and development incentives*

While Canadian affiliates have access to enormous pools of technology, research and development incentives, particularly development incentives, can positively influence mission specialization. These incentives are most effective when they are applied to the full range of product and process activities, rather than only to new or incremental activity. This concept is broader than the definitions of research and development used in existing incentive programs. In addition, incentive programs should make provision for government-funded research and development to be exploited from other than a Canadian base in order that Canadian affiliates can compete for specialized research missions. This would allow affiliates to undertake contract research which in turn strengthens their technical capability for product development.

### *c) Export support*

The Hatch Committee on Export Development made a number of recommendations which would allow Canadian companies to compete more favourably in export markets. Early implementation of these recommendations could help Canadian affiliates compete for specialized missions.

### *d) Government procurement*

Government procurement policies can be used to encourage affiliates to evolve to specialized missions. However, government procurement policies must be consistent with related policies promoting specialized missions. In addition, governments must ensure that such policies are not inconsistent with GATT.

The primary objective of these policies as they relate to affiliates should be to encourage them to become world-competitive. In evaluating an affiliate's performance, procurement agencies should use as their major criterion the affiliate's *overall* contribution to Canada's national objectives.

## **2. Market Access**

Governments can assist Canadian manufacturers, including multi-national affiliates, in accessing larger markets to justify the increased investment and to provide the economies of scale required to develop world-competitive enterprises.

*a) Increased economic co-operation among the various provinces and regions of Canada*

The increasing fragmentation of the Canadian market is a growing concern for all manufacturers, including multinational affiliates. Enterprises in all parts of the country must be allowed fair and equal access to the entire Canadian market. Governments must cooperate to prevent undue and detrimental competition among the various regions and provinces of Canada.

*b) Non-tariff barriers to trade*

With the implementation of the most recent changes in GATT, there is a danger that some countries will be tempted to introduce non-tariff barriers as a form of market protection. Canada's trading partners should be monitored and urged to remove such barriers, so that manufacturers in Canada can compete fairly in foreign markets.

*c) Dumping*

Dumping is a form of unfair competition which can have a negative impact on all Canadian manufacturers, including multinational affiliates with specialized missions. Accordingly, governments must exercise vigilance to ensure that injurious dumping is discouraged.

*d) Bilateral arrangements*

The very real potential of increased government intervention in the economies of the advanced nations, ostensibly to protect their economic

sovereignty, may result in some deterioration in the international trading environment. If multinational affiliates are to adopt specialized strategies successfully, a positive trade environment must be preserved and strengthened among the industrialized nations. This is particularly true with respect to our relationship with the United States, the source of most competition to Canadian affiliates attempting to develop specialized missions. With this in mind, our governments would be well advised to place increased emphasis on bilateral arrangements with Canada's major trading partners.

### 3. Canadian Sourcing

The more Canadian affiliates source from competitive Canadian suppliers, the greater the total benefit to Canada. The development of sophisticated and capable Canadian suppliers can also enhance the ability of Canadian affiliates to compete for and maintain specialized missions within a multinational enterprise.

Government and industry can and should work more closely together to facilitate the broadest possible development of Canadian suppliers by multinational affiliates operating in Canada.

To more effectively coordinate domestic sourcing activities, a *joint industry-government committee* should be established to promote increased sales to multinationals by Canadian firms. The committee should be made up of representatives of government, multinational affiliates and organizations such as the Canadian Federation of Independent Business, which has expressed a strong interest in this area. The committee should concentrate its efforts on programs to expand the subcontracting of products and services to Canadian suppliers. A specific effort should be made to identify impediments to local sourcing and to identify opportunities for local supply. The committee should participate with government in a coordinated effort to inform industry of government support and of any incentives available to promote Canadian sourcing. It should seek to involve more multinational affiliates in an active effort to maximize Canadian sourcing.

#### 4. Measures to Promote Specialized Missions

The committee believes there is a need for specific consultative efforts by government to encourage more Canadian affiliates to consider the advantages of specialized missions.

##### a) Consultation

To provide a continuing focus on specialized mission strategies, the committee recommends the establishment of a *working level consultative committee* made up of

representatives of government and multinational enterprises. In addition to acting as a resource group to support the development of specialized missions, the committee could explore suitable mechanisms to recognize the contribution of particular multinationals. Favourable publicity acknowledging good corporate citizenship can only be helpful.

##### b) Government assistance

Managers of Canadian affiliates sometimes require assistance in developing a business case to justify a specialized mission. Governments can usefully offer *direct* help to the Canadian managers of multinational affiliates in developing their business cases, including, but only where appropriate, joint approaches to the parent firm.

##### c) Communications

While no "blueprint" solution exists, Canadian affiliates successfully employing specialized mission strategies could help identify and promote the advantages of the concept to firms which have not yet adopted such strategies. Governments should promote such consultation and communication between interested firms.

## VI. Conclusions

In our view, Canada's overall objective for the manufacturing sector should be *the development of world-competitive enterprises*. The key to achieving this objective for multinational affiliates is to encourage them to adopt some form of specialized mission strategy.

To this end, governments and the Canadian managers of multinational affiliates need to establish effective means of consultation. The interests of the two groups are parallel; both wish to maximize the economic strength of the affiliates involved.

In this report, we have identified areas of concern and initiatives which should be pursued. Based on practical experience within our own enterprises, we believe Canadian multinational affiliates can earn and maintain attractive specialized missions.

This report should not be interpreted as encouraging extensive government intervention. Rather, the government

should strive to provide a supportive environment in which Canadian affiliates are free to implement the strategies and approaches they believe can best lead to such specialized missions in accordance with the unique requirements and characteristics of their own multinational enterprises.

We trust that this report will serve as a useful basis for ongoing consultation between industry and government on strategies which can lead to the development of a world-competitive manufacturing sector in Canada.

